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AGENDA ITEM 9b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Member Home Loan Program Manager Annual Review
- II. **PROGRAM:** Member Home Loan Program (MHLP)
- III. **RECOMMENDATION:** Extending CitiMortgage Inc.'s contract for a period of one year.
- IV. **ANALYSIS:**

Background:

The CalPERS MHLP was created by statute in 1981. Government Code Section 20200 established a home loan program to help Members secure a purchase-money or refinance loan. Since the inception of the program, over 126,520 loans have been originated, exceeding \$20.1 billion in volume.

Effective April 1, 2003, CitiMortgage, Inc. was awarded CalPERS Contract No. 2002-2987. Under this contract, CitiMortgage serves as mortgage loan master servicer and manager of the CalPERS MHLP. CitiMortgage has general administrative and supervisory responsibility of the program and provides uniform reports and services to CalPERS. Among other duties, CitiMortgage:

- Supervises and coordinates activities of participating lenders
- Markets and advertises the MHLP to participating lenders and CalPERS members
- Purchases mortgage loans originated under the MHLP
- Warehouses these mortgage loans following purchase
- Pools and securitizes loans prior to sale to CalPERS

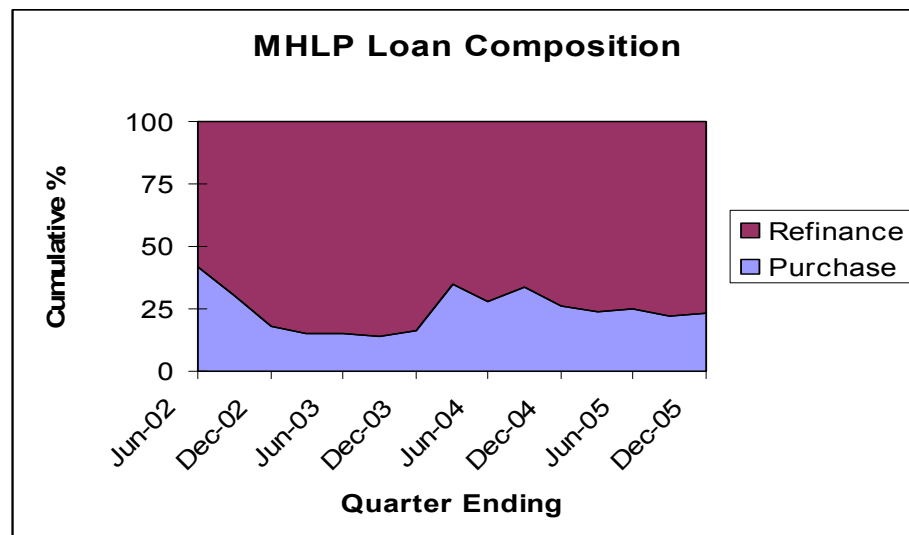
- Funds and services loans originated under Personal Loan Program
- Acts as master servicer for the MHLP

Market Environment:

Declining interest rates in the early 2000's spurred successive waves of refinance activity. Combined with a brisk housing market, the MHLP financed a high volume of home loans.

The vast majority of real estate loans originated under the MHLP are secured by one-to-four unit residences located within California. As real estate prices continue to escalate, housing affordability has become a national issue and is exceptionally relevant in California. Purchase transactions have increasingly been financed by adjustable rate mortgages, hybrid ARMs and interest-only loans. CitiMortgage is working with CalPERS to develop and introduce new loan programs to ensure the MHLP remains a viable option for the system's members.

The following graph illustrates the purchase-refinance composition of funded loans under the MHLP since the inception of the current contract:



CitiMortgage Performance:

CitiMortgage has successfully managed the loan production efforts of participant lenders and has satisfactorily performed its warehousing, pooling, securitization, sales and servicing functions.

Participant Lenders

CitiMortgage supervises the activities of 45 participant lenders (“correspondents”) with a total of 594 branch locations. These lenders may directly originate home loans offered under the MHLP. Each lender enters into a Participant Agreement with CitiMortgage and is expected to abide by CitiMortgage’s web-based MHLP Participant Guide, which provides detailed program offerings, marketing guidelines and general protocol for originating, funding and delivering loans. CitiMortgage updates the Participant Guide frequently on an as-needed basis.

CitiMortgage also regulates the activity of seven wholesale lenders that participate in the MHLP. Loan officers not working for a correspondent may originate a CalPERS Member home loan via these wholesale sources.

Marketing and Advertising:

CitiMortgage markets the program by attending numerous benefit fairs and events, providing paycheck inserts three or four times per year, maintaining the MHLP portion of CalPERS website and by conducting seminars to state departments throughout California. In addition, part of the MHLP’s success stems from co-worker referrals and informational promotions by correspondents.

Additionally, CitiMortgage outreaches to the membership by writing various articles pertinent to the MHLP in CalPERS publications such as Employer News and PERSpective.

CitiMortgage educates correspondents about the program and provides program updates when necessary. CitiMortgage also provides critical customer service by handling member inquiries and complaints, and resolving most MHLP issues without requiring CalPERS staff assistance.

Purchasing, Warehousing and Selling Loans

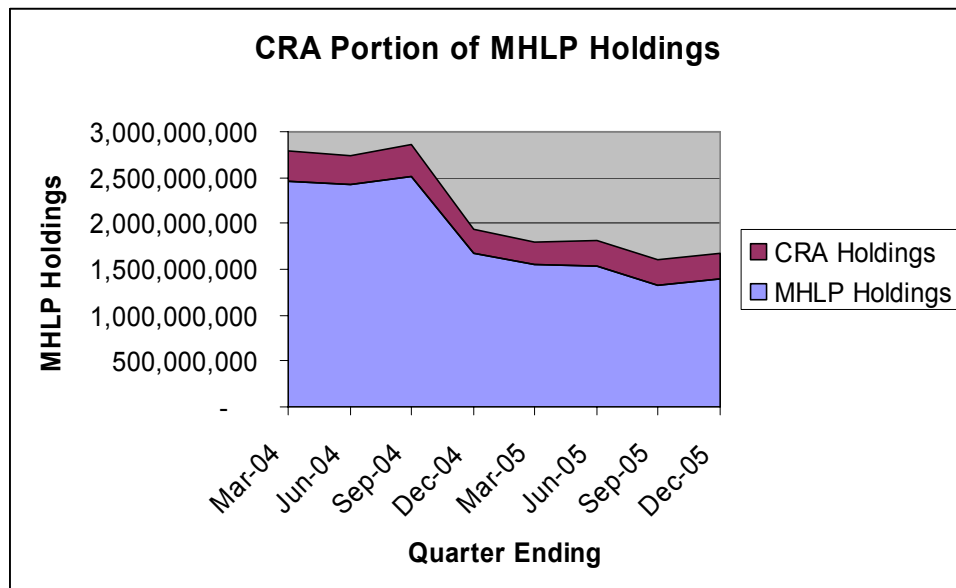
CalPERS purchases loans for its portfolio that were originated under the MHLP. CitiMortgage helps securitize conforming loans via Fannie Mae (FNMA) prior to sale to CalPERS. Non-conforming loans and loans originated under CalPERS Secured Personal Loan Program (which helps provide 100% financing to homebuyers under authority granted by Government Code Section 20201) are sold directly to CalPERS as whole loans.

Over the last ten years, CalPERS purchased the following volume of conforming, whole and personal loans from the program manager:

Year - Ending	MHLP Volume
1996	\$601,455,614
1997	\$644,965,586

1998	\$877,832,676
1999	\$1,327,519,355
2000	\$1,027,622,735
2001	\$3,639,624,745
2002	\$2,456,864,732
2003	\$3,970,831,936
2004	\$610,401,408
2005	\$748,241,589

Starting in 2004, CitiMortgage tracked MHLP loans qualifying under the Community Development Act (CRA). CRA loans are those provided to borrowers whose incomes are less than 80% of the counties median income in which the property is located. As a percent of total MHLP holdings, CRA loans increased from 12.83% in March 2004 to 19.53% in December 2005.



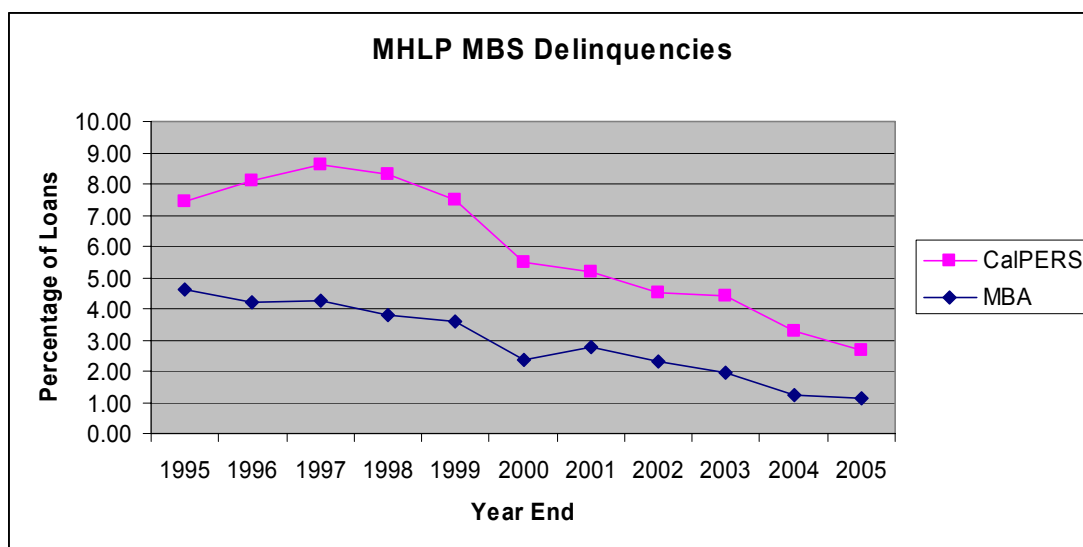
Reporting:

CitiMortgage provides CalPERS with various MHLP reports in a timely manner including monthly loan production and loan delinquency reports. CitiMortgage also provides a quarterly report which is submitted to the Board. The quarterly report provides the Board informational highlights of the MHLP, security purchase volume by investment type, current portfolio holdings, delinquency summary, participating lender list, and qualifying standards for service-retained and service-released participants. Staff has been satisfied with the timeliness and content of these reports.

Master Servicing:

In the capacity of master servicer, CitiMortgage performs a variety of functions, including: oversee mortgage servicers who maintain MHLF loans in their portfolio, receive and reconcile monthly remittances and reports from primary servicers, aggregate and remit consolidated data and funds to CalPERS, monitor defaulted loans to assure servicers are effectively pursuing loss mitigation, monitor liquidation of defaulted loans to assure all funds due CalPERS are collected and remitted, audit practices of primary services, monitor the servicers compliance items, and annually review each correspondent's financial condition.

CitiMortgage submits timely production and delinquency reports to CalPERS. The following graph reveals the MHLF mortgage-backed security delinquency rates compared to Mortgage Bankers Association (MBA) figures:



A higher delinquency rate is reported for MHLF loans versus the industry, but largely this is due to timing differences. CitiMortgage serves as master servicer for multiple correspondents choosing to retain servicing rights for MHLF loans. CitiMortgage requires from these correspondents delinquency figures no later than the 25th of each month so CitiMortgage has time to aggregate figures and subsequently meet Fannie Mae's reporting deadline of the 1st of each month. In contrast, MBA figures are predominantly those of single-servicers which may advantageously wait until months end to report. During this interim week, many borrowers make their mortgage payment to avoid a 30-day late or other derogatory credit item. The difference between CalPERS and MBA is negligible when one looks at 90-day delinquency statistics. As of December 31, 2005, only 0.06% of MHLF loans were 90-days delinquent, compared to a 0.07% delinquency statistic reported by MBA for conventional loans in California.

V. STRATEGIC PLAN:

Monitoring and review of CalPERS Member Home Loan Program is consistent with Goal V: Provide sustainable pension benefit products and services responsive to and valued by members, employers and stakeholders.

VI. RESULTS / COSTS:

Contractually, there is no base fee paid to CitiMortgage for managing the CalPERS Member Home Loan Program. CitiMortgage earns income via master servicing fees, primary servicing fees on service-released loans, late fees, participant lender recertification fees, warehouse income (spread earned prior to sale), and from buying excess servicing of mortgage-backed securities.

CalPERS' costs of the MHLP primarily involve staff time to oversee CitiMortgage's program management and marketing responsibilities, and to consummate investments in the mortgage-backed securities, whole loans and personal loans originated under the program.

Staff recommends extending CitiMortgage contract for one year.

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